

# GOVERNANCE AND SUSTAINABILITY

—  
*DEFINING OUR APPROACH*  
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2019 Principles and Guidelines



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*Too often in asset management active ownership, or 'stewardship', takes second place to stock selection, and governance and sustainability matters are an afterthought. As a truly long-term investor these issues are central to how we invest, how we manage our own affairs, and how we interact with our clients. As a private partnership, we know from our own experience how critical ownership structures and corporate cultures are to good long-term outcomes.*

*Our low portfolio turnover relative to our industry highlights our genuinely long-term perspective. If you analyse a company's business prospects over the next decade, not the next quarter, you have to think deeply about the way it interacts with a variety of stakeholders.*

*We think that there needs to be a much more open and honest conversation among all stakeholders about how the financial sector interacts with society, and about the rules and behaviours that underpin those interactions. The interconnected relationships between asset owners, investors and company managers are central to that conversation, and to the task of reconnecting savers with the users of their capital through good stewardship.*

*For all of these reasons, governance and sustainability really matters to us. The following principles and guidelines set out our thinking in this fundamentally important area of our business.*

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# *BAILLIE GIFFORD*

## *GOVERNANCE AND SUSTAINABILITY*

### *PRINCIPLES*

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#### **WHAT DO WE MEAN BY ‘CORPORATE GOVERNANCE’?**

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**Corporate Governance** is the combination of a number of different aspects relating to the control, oversight and management of a company. Despite extensive regulation and the creation of a number of national-level corporate governance codes, companies still have broad discretion over how they choose to be incorporated, governed and operated. As long-term investors we pay close attention to these variables, taking particular interest in the following areas of a company’s business:

- The capital structure, articles of incorporation, and the country or countries of incorporation and listing
- The treatment and protection of minority shareholders
- The alignment of interests between management, strategic shareholders and other investors
- The make up and effectiveness of the board of directors, the quality and performance of management, and the remuneration of key employees
- The corporate culture and approach to sustainable business, and the management of relationships with customers, employees, suppliers, regulators and the wider community

We focus on corporate governance not because of an interest in shareholder rights *per se*, but because we believe that governance really matters with respect to long-term investment performance. Our ongoing assessment of corporate governance issues may change our view on buying, selling or resizing our clients’ holdings. It also determines how we choose to vote at company meetings and how we engage with management, the two principal levers we have for influencing change.

This combination of ongoing company monitoring and ‘active ownership’ through voting and engagement is what we think of as stewardship.

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## WHAT DO WE MEAN BY SUSTAINABILITY?

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We believe that a company cannot be financially sustainable in the long run if its approach to business is fundamentally out of line with changing societal expectations. We define ‘sustainability’ as a deliberately broad concept which encapsulates a company’s purpose, values, business model, culture, and operating practices.

With ever increasing scrutiny and disclosure requirements, businesses are having to pay more attention than ever before to their relationship with stakeholders and wider society. In response to mounting evidence of environmental challenges, the United Nations’ Brundtland Report of 1987 defined sustainable development as ‘the kind of development that meets the needs of the present without undermining the ability of future generations to meet their own needs’. For business, this can be reinterpreted as ‘making profits in a way today that does not undermine the ability of the firm to generate profits in the future’.

As expectations and regulations continue to raise the bar, we closely monitor and analyse developments at our holdings in this increasingly important area of business. In common with many organisations, we have found the United Nations Sustainable Development Goals to be particularly instructive, as a widely endorsed benchmark for assessing progress.

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## WHAT DO WE CONSIDER TO BE ‘BEST PRACTICE’ IN CORPORATE GOVERNANCE?

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There is no simple answer to this. Just as there is no universally ‘right’ way to invest in the stock market, or to manage a pension fund, there is no ‘one-size-fits-all’ approach to corporate governance that should always be followed. We are open minded about the different ways to govern and manage a company, and we are pragmatic about the significant differences in both expectations and actions that exist across different countries. For example, we don’t have a fixed view with regards to the composition of a company’s board of directors. Effective boards can and do take many forms, and some of the least effective boards conform to the full range of widely accepted corporate governance ‘norms’.

For this reason, we are sceptical of the usefulness of overly prescriptive policies and checklists when analysing, engaging and voting on corporate governance issues. Just as our investment research is bottom up, we prefer to take a case-by-case view on governance, focussing on what works in practice:

- Are we consulted by management?
- Are we respected as minority holders?
- Is executive compensation consistent with performance?

Ultimately, we want to be in a position where we can step back and trust management to take a long-term view and to look after our clients’ interests as minority shareholders.

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## HOW DO WE EMBED GOVERNANCE AND SUSTAINABILITY CONSIDERATIONS IN OUR INVESTMENT PROCESS?

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Our long-only, active approach to investment is based on identifying and holding high quality growth businesses that enjoy sustainable competitive advantages in their marketplace. To do this we look beyond current financial performance, undertaking proprietary research to build up an in-depth knowledge of an individual company and a view on their long-term prospects. This focus on ‘bottom up’ research also applies to our work on governance and sustainability.

We are also comfortable with our various investment strategies taking different approaches to reach the same goal of properly assessing and weighing up governance and sustainability considerations in the investment process. The general principles outlined below are however valid across all of our investment teams.

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## RESEARCH AND ENGAGEMENT

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Governance and sustainability considerations are not separate side issues, they are central to our investment process. All of our investment staff share the responsibility for identifying, analysing and monitoring issues and opportunities with our current and potential holdings. Our investment staff spend a very significant amount of time assessing the quality, integrity, motivation and culture of management teams, and then acting on their convictions. The work of our dedicated Governance & Sustainability team supports this.

As active managers we have regular meetings with management and board members to identify and understand issues and to monitor performance. Analysts from the Governance & Sustainability team regularly join our investors for these meetings, in addition to meetings that they will arrange directly with company representatives to discuss specific issues.

When engaging with companies on governance issues, we have clear objectives. Where we do have reservations about a company’s approach we prefer to encourage change through active ownership rather than divestment in the first instance. This will range from communications expressing concern through to face-to-face meetings with management and, where appropriate, voting against management. If we have been unable to exert any influence over a company on a material issue over a protracted period of time our investment managers will consider reducing or selling our holdings.

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## VOTING

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Thoughtful voting of our clients' holdings is an integral part of our commitment to stewardship. We believe that voting should be investment-led, because how we vote is an important part of the long-term investment process, and for this reason we always strongly prefer to be given this responsibility by our clients. The ability to vote our clients' shares also strengthens our position when engaging with investee companies. Our Governance & Sustainability team oversees our voting analysis and execution in conjunction with our investment managers. Unlike many of our peers, we do not outsource any part of the responsibility for voting to third-party suppliers. We utilise research from proxy advisers for information only. Baillie Gifford analyses all meetings in-house and we endeavour to vote every one of our clients' holdings in all markets. However, on occasion this may not be possible due to a practice known as share blocking, whereby voting these shares would result in us being prevented from trading for a certain period of time. Additionally, we are not able to vote clients shares if their stock is on loan, a common industry practice which we discourage because of the potential impact on our voting rights. If we deem a meeting to be significant or contentious, we may consider requesting that clients recall any stock on loan to enable us to vote.

We will always review the merits of proposals on a case-by-case basis rather than following restrictive checklists. Checklists often by necessity revert to focussing on inputs rather than outcomes. For example, it is easier to draw up a rule dictating how many other company boards a director can be on than to try to determine whether their performance as an independent director is effective. A formulaic approach to governance can often lead to recommendations that just don't make sense to us in an investment context – attempting to vote a successful founder CEO off the board because they are also company chairman for example.

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## IS ESG THE SAME AS GOVERNANCE AND SUSTAINABILITY?

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ESG is the acronym for 'Environmental, Social and Governance' issues. It has emerged as an industry shorthand for a very broad range of matters relating to how a company is governed and its impact on society. Whilst it is now a widely accepted term, we prefer to focus on governance and sustainability as broader interlinked concepts which also factor in a company's performance on environmental and social issues – a business with an unacceptable environmental record for example is a poorly governed one that should be a priority for engagement, and if necessary, voting action.

*We will always review the merits of proposals on a case-by-case basis rather than following restrictive checklists.*

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## INVESTMENTS IN OTHER ASSET CLASSES – MULTI ASSET AND FIXED INCOME

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In addition to equities, we invest in a range of other assets through our multi asset and fixed income teams. We believe governance and sustainability factors are applicable and important across all asset classes and therefore take these issues into account as part of the investment process.

### Multi-Asset – Real Assets

Within our real asset class allocations (commodities, infrastructure and property), longer-term governance and sustainability trends and factors can often be clearly identified. For example, environmental considerations can play an important role in the long-term attractiveness of a property investment or infrastructure project. As with other asset classes, our policy here is focused on engagement rather than exclusion. All relevant factors are taken into account as part of our investment analysis, and the integration of governance and sustainability factors allows a better assessment of the risks involved. Investment in these asset classes can often offer the opportunity to support sustainable projects or benefit from relevant technological developments.

### Multi-Asset – External Managers

Where we invest in externally-managed vehicles as a means of accessing desired asset classes, we employ a thorough due diligence process to select and monitor investments, including seeking managerial alignment with our own governance and sustainability beliefs and practices. We engage regularly and pro-actively with the management and boards of these vehicles to monitor and progress relevant governance and performance issues.

### Fixed Income – Corporate Bonds

Alongside a company's long-term competitive position and capital structure, governance and sustainability factors are considered as a key component in assessing a bond issuer's fundamental financial resilience. As well as providing warning signs of upcoming issues, governance and sustainability factors can also signal improvements in a company's general investment attractiveness. As such, we believe additional governance and sustainability analysis adds value in both controlling risk and identifying opportunities for outperformance. The materiality of these factors will vary depending on the company's sector, region and the strength of its financial position.

Strong governance and sustainability factors may increase our enthusiasm for an investment. Conversely negative performance may weigh against a potential investment, causing us to hold a smaller position than we otherwise might, demand a higher risk premium, or not proceed with an investment at all.

### Fixed Income – Sovereign Bonds

When we consider investing in a country's bonds we examine key governance and sustainability factors to help consider associated risks, the country's broad direction of travel and if our provision of capital is likely to aid its progression. We believe that if a country is governed effectively, its people are respected, and its natural assets are managed responsibly, there is a greater chance it will enjoy sustainable growth and development, and be in a better position to repay bond debt.

These factors are integrated within our analytical framework, which rests on three key areas, macroeconomic sustainability, economic management and growth potential. This framework allows us to identify and focus on the risks specific to the potential investment being analysed, from political stability in one country to environmental pressure in another, and to monitor these risks on an ongoing basis.

*We believe governance and sustainability factors are applicable and important across all asset classes.*

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## STEWARDSHIP

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Our commitment to responsible stewardship of our clients' holdings is as old as our firm. Our clients trust us to oversee and manage their investments for the long-term, and stewardship of their holdings is a core part of this commitment. All of our investment staff are involved in our stewardship work, and as long-term investors we believe that our approach to monitoring holdings, engaging with management and voting thoughtfully supports investment performance. When you aim to invest in a company for many years, ongoing oversight of the business is just as important as the initial investment decision.

But we also believe that we have a wider 'stewardship' role to play in encouraging responsible, long-term capitalism. Companies' approach to governance issues can have a very material impact on society, and we should continue to use our influence to encourage sustainable long-term practices. More broadly, our business is based on our ability to invest in stable and functional public markets. It is therefore in our own long-term interests to ensure that the business sector enjoys ongoing stakeholder support and political, legal and regulatory backing around the world. This will only happen if companies are seen to be operating with integrity and in a way that respects the interests of wider society.

*...we also believe that we have a wider 'stewardship' role to play in encouraging responsible, long-term capitalism.*

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# *BAILLIE GIFFORD 2019 VOTING AND ENGAGEMENT GUIDELINES*

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## INTRODUCTION

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We believe that ‘active ownership’ of our clients’ holdings is just as important as selecting the right investments. These guidelines describe our approach to proxy voting and company engagement, the key levers of active ownership, often described as ‘stewardship’. Whilst the guidelines are intended to provide an insight into how we approach voting and engagement on our clients’ behalf, it is important to note that we assess every company individually. With respect to voting, we will always evaluate proposals on a case-by-case basis, based on what we believe to be in the best long-term interests of our clients, rather than rigidly applying a policy.

Furthermore, just as our approach to investment is based around empowered and independent teams, our voting and engagement is investment-team led, and all members of our investment staff are involved in our ongoing work on stewardship. In keeping with our decentralised and autonomous culture, our investment teams will on occasions elect to vote in different ways on the same general meeting resolutions. When we do this we will report accordingly in the proxy voting disclosure on our website. We also have in place clear processes to identify, prevent and manage potential proxy voting related conflicts of interest. Baillie Gifford’s firm wide conflict of interest disclosure is available on our website. Whilst these guidelines primarily relate to listed equities, we also carefully consider relevant governance and sustainability issues in voting, research and engagement for other asset classes, such as fixed income and unlisted equity investments.

As a core part of the way we invest, our investment staff aim to meet with company leadership teams to understand their business strategy and to discuss and monitor progress, both before and after we take a holding. We believe that ongoing dialogue between investors and companies on strategic issues can protect and enhance our clients’ long-term returns, although we are equally mindful of the importance of not attempting to ‘micro-manage’ our holdings in areas where we have no special expertise or insight, or distracting management from their core role of running the business for the long-term.

Engagement to address specific governance and sustainability concerns usually precedes any voting action set out in these guidelines. The issues on which we focus will vary between geographic regions, industry sectors and between individual companies, and will be informed by our own research, but will typically cover areas set out within these guidelines. As well as communicating directly with our holdings, when appropriate we will on occasion engage collaboratively with other shareholders through a range of different industry organisations and associations. Further details of the industry organisations that we support are available on our website.

The guidelines are divided into five sections:

- Board Effectiveness and Composition
- Capital Allocation
- Governance Processes and Disclosure
- Remuneration
- Sustainability

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## I. BOARD EFFECTIVENESS AND COMPOSITION

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### BOARD EFFECTIVENESS

Effective company boards should perform a number of key functions. First and foremost, they should provide oversight to executive management teams, regularly reviewing performance against a defined strategy, recognising and supporting success but taking firm action if changes of direction or leadership are required. Specifically, we expect boards to perform a number of important functions:

- to undertake effective succession planning for key roles
- to put in place an appropriate and effective remuneration plan to attract, retain, motivate and direct key executives
- to put in place the necessary risk management framework and controls on corporate activity
- to review and where necessary challenge key capital allocation decisions, ensuring that management teams are taking a long-term approach to business planning
- to appoint, monitor and set the remuneration for a suitably qualified and independent financial auditor
- to undertake a formal and transparent process for nominations and appointments to the board, the details of which should be fully disclosed in the annual report
- to regularly evaluate the effectiveness of their own work, taking appropriate measures to address any priority issues
- to ensure that management are working within the legal and regulatory norms of their countries of operation and that stakeholders of the business are treated fairly

If a board of directors is persistently failing to exercise one or more of these key responsibilities, we will aim to engage with the company in the first instance and will consider taking additional voting action if appropriate.

### BOARD COMPOSITION

With regards to the composition of the board of directors, we generally prefer to see a number of features:

- a majority of independent non-executive directors on the main board, and fully independent audit and remuneration committees with at least three members
- the appointment of a senior or lead independent director
- an effective mix of qualifications, experience and diversity
- directors with the appropriate time available to focus on their responsibilities given their other commitments and directorships

Companies should be able to demonstrate an appropriate level of commitment, independence and diversity on the board. If the composition of a board or its subcommittees is very different from these expectations, we will aim to engage with the company in the first instance, and may also consider taking additional voting action against appropriate directors. We also believe that independent directors should be periodically available to engage with shareholders.

## **THE ROLES OF CHAIRMAN, CHIEF EXECUTIVE AND SENIOR (OR LEAD) INDEPENDENT DIRECTOR**

We generally support the separation of the roles of chairman and chief executive, although we recognise that these roles have been very successfully combined in a number of our holdings. If the roles are combined, the company should ideally have a majority of independent directors on the board and appoint a senior or lead independent director with clearly defined responsibilities separate from that of the chairman to mitigate the risks associated with combining the positions. This should include the senior independent director having the right to periodically convene a meeting of the independent directors with the full support of the company. Additional actions to strengthen corporate governance should also be considered where appropriate, such as enhanced authorisation, audit and disclosure requirements.

We also typically prefer that companies do not appoint a retiring CEO as chairman, however we recognise that in exceptional cases this may be in shareholders' best interests. In these circumstances, the board should explain why it is appropriate and we will consider the justification on a case-by-case basis.

## **DIRECTOR TENURE**

We believe that companies should be mindful of the value of periodically refreshing the composition of the board of directors. Whilst we recognise the value that long serving directors can bring in terms of continuity and experience, when director tenure exceeds nine years of service we will no longer consider the director to be independent at that point, in keeping with the UK Corporate Governance Code.



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## II. CAPITAL ALLOCATION

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### EQUITY ISSUANCE

We consider companies' requests to raise additional capital with or without pre-emptive rights on a case-by-case basis, taking account of their specific circumstances and local market practice. We believe that pre-emptive rights are important to protect shareholders from detrimental levels of dilution, although we recognise that in some instances it is appropriate for companies to have the flexibility to issue shares without first offering them to existing shareholders on a pre-emptive basis. We also typically prefer that shareholders are given the opportunity to vote on the issuance of large amounts of capital. In both instances the onus is on the board to clearly demonstrate that the request is necessary and proportionate.

Although individual investment teams have different levels of preference in this area, we will typically approve requests to issue up to 5 percent of authorised capital without pre-emption rights and up to 20 percent of authorised capital with pre-emption rights, unless we have concerns about a company's leadership, capital allocation track record or proposed use of funds. Beyond these limits we will evaluate requests on a case-by-case basis taking into account the views of our investment teams.

### ALLOCATION OF INCOME AND DIVIDENDS

We support the efficient and effective use of shareholder capital and normally expect to vote in favour of the allocation of any dividend. However, many profitable companies (especially in Japan) continue to propose unusually low dividend payments without an adequate explanation, deciding to retain cash on their balance sheets. In such instances we will typically oppose the proposed dividend.

Furthermore, where we have significant and ongoing concerns over a company's capital allocation policy, we will endeavour to engage with management to encourage improved practices and then take appropriate voting action where necessary.

### MERGERS, ACQUISITIONS AND DISPOSALS

Corporate restructuring such as mergers, acquisitions and disposals can clearly have a very significant impact on shareholder value. We carefully consider all such proposals on a case-by-case basis.

### POLITICAL DONATIONS

We generally oppose all resolutions that seek approval for intentional political contributions, and we will usually support shareholder resolutions which oblige companies to report to shareholders on their political contributions.

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### III. GOVERNANCE PROCESSES AND DISCLOSURE

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#### ANNUAL GENERAL MEETINGS

All listed companies should aim to ensure that an annual shareholder meeting takes place where substantive matters are submitted for shareholder approval. All shareholders should be actively solicited for their voting instructions. All paperwork, and in particular an annual report signed off by the appointed auditor, should be available well in advance of the meeting to allow due consideration by investors ahead of any relevant regulatory and market proxy voting deadlines. In the limited number of markets where the above features are not common practice, we will engage with issuers and relevant third parties to encourage change and consider taking voting action where appropriate.

#### DIRECTOR ELECTIONS

As a general principle we believe that all directors should be subject to annual, individually proposed majority voting standard elections. There are several current alternatives to this:

- ‘Plurality voting’ enables uncontested board nominees to be elected with a single affirmative vote, even if all other votes are withheld
- ‘Cumulative voting’ allows shareholders to direct all or any of their votes to single or multiple directors
- ‘Bundled’ director elections are when several or all directors are proposed as a single resolution, without the ability to support or oppose individual directors
- ‘Classified’ boards is the term for when only a subset of directors are put up for election each year

We believe that each of these alternatives can potentially undermine individual director accountability, although we recognise that there may on occasions be company specific circumstances that support such voting arrangements.

We are supportive of management and shareholder resolutions calling for alternative director voting

procedures to be replaced by a simple majority voting standard on an annual basis. When asked to vote in cumulative elections, we will typically allocate our votes equally across independent directors on the ballot, unless we have specific concerns about their effectiveness or a desire to see a particular director on the board.

#### AUDITORS

The appointment of auditors should ideally be submitted to an annual shareholder vote. We will consider voting against the appointment of the auditors if we have concerns about their independence, level of non-audit fees, audit quality, or where a company changes its auditor without providing an adequate explanation to shareholders.

We believe that it is good practice to rotate the lead audit partner at least every five years and to limit continuous audit firm tenure to a period of no more than twenty years, in line with a number of current market guidelines.

Non-audit fees paid to the audit firm should not typically exceed audit fees, except for a limited period (and not for more than two consecutive years) where there are exceptional circumstances which support that position. In this case the company should provide additional disclosure on the nature of the non-audit work undertaken by the audit firm.

#### APPOINTMENT OF STATUTORY AUDITORS (JAPAN)

Statutory auditors play an important role in defining audit policy in the Japanese market, supervising the external audit of a company’s financial statements and advising the board. Given their responsibilities we have a preference for outside nominees. We will assess internal candidates on a case-by-case basis giving consideration to the materiality of their relationship with the company and the presence of other external statutory auditors.

## **PROXY ACCESS**

Proxy access is the ability for a shareholder or group of shareholders to nominate candidates to the board. We are supportive of proxy access in principle, believing that long-term shareholders should have the ability to place director nominees on the proxy ballot. Whilst we are likely to support proposals based on the terms outlined above, we will review each resolution on a case-by-case basis. We also welcome the opportunity to engage with investee companies in order to structure an appropriate policy which enhances board accountability and responsiveness to shareholders but also limits potential abuse by shareholders without a meaningful long-term interest in the company.

## **‘POISON PILL’ ANTI-TAKEOVER DEVICES**

We will generally oppose proposals for new anti-takeover devices, particularly when introduced post-Initial Public Offering. We will also usually support shareholder proposals that request a company to submit a shareholder rights plan to a shareholder vote or to revoke a poison pill.

We will evaluate proposals to modify or remove existing shareholder rights plans or poison pills on a case-by-case basis. Whilst many anti-takeover devices have the potential to entrench management and damage shareholder value, there may be certain growth-oriented companies and sectors where we believe that an element of protection from short term market priorities can support long-term shareholder value creation.

## **ARTICLES OF ASSOCIATION**

We review amendments to a company’s articles of association within the context of the company’s business strategy and shareholders’ best interests. Accordingly, we will usually oppose any proposed changes that have the potential to erode shareholders’ rights.

## **SHAREHOLDER RESOLUTIONS**

Shareholder resolutions are a mechanism permitted in a number of markets which enable shareholders to table proposals at company meetings relating to any aspect of a company’s business. We review each resolution on a case by-case basis and prior to voting will consider the company’s current approach to the issue, its response to the resolution, and whether the resolution is workable and in the best interests of all stakeholders.

## **BUNDLED RESOLUTIONS**

In some markets it is still common for companies to ‘bundle’ together proposals such as the election of directors, or amendments to articles of association. This practice reduces shareholder discretion by preventing voting on separate issues. For example, if shareholders have concerns about one specific director, the only option may be to vote in favour or against the entire board, which may be counterproductive. Nonetheless, we will vote against bundled resolutions where we have serious concerns and it is in shareholders’ best interests. We will communicate our views to the company and encourage the separation of all relevant matters as separate resolutions in the future.

## **RELATED PARTY TRANSACTIONS**

As a general principle, we believe that large shareholders should recuse themselves from voting if they have involvement in related party transactions. Most markets have specific disclosure rules on related party transactions and require approval from minority shareholders. We consider such transactions carefully to determine if they are appropriate and in our clients’ best interests.

## **MULTI CLASS SHARE STRUCTURES**

The use of dual and multi class share structures is common in a number of regions where listing rules allow. Whilst the one-share, one-vote principle clearly provides alignment of voting rights and economic rights for all holders, we appreciate that multiple share structures with different voting rights can enhance long-termism and protect the strategy and culture of some organisations. Accordingly, we will assess all proposals to introduce additional share classes or amend existing voting rights on a case-by-case basis.

## **DISCLOSURE**

Levels of disclosure vary significantly between sectors and countries. We believe that all issues which are material should be set out succinctly in an annual report, and that the approach to governance and sustainability matters should be reported in the context of the whole range of risks and opportunities faced by the company.

Whenever disclosure on key financial, governance and sustainability information is significantly below expectation and an impediment to exercising our stewardship responsibilities for our clients, we will endeavour to engage with the company in the first instance and will consider taking appropriate voting action where necessary.

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## IV. REMUNERATION

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Effective remuneration policies help to recruit, retain and motivate the best available talent, whilst also incentivising management to focus on the right long-term priorities of the business. We encourage our investee companies to develop robust and transparent pay practices which provide clear alignment with long-term shareholders, reward outstanding performance and which mitigate against excessive risk taking or unintended consequences arising from a narrow focus on inappropriate targets. In addition to this, companies should also take due account of increasing public scrutiny of executive pay practices and should be cognisant of the reputational and regulatory risks of excessive or inequitable pay practices. We believe that substantive changes to executive remuneration policies should be submitted to a shareholder vote. We also welcome the opportunity to engage with our investee companies on material remuneration matters.

To achieve the right overall balance, we expect Remuneration Committees to take full responsibility for this process, taking independent advice as necessary. They should retain discretion to make upward or downward revisions in exceptional circumstances, particularly where such action is clearly aligned with long-term shareholder interests. To enable effective assessment of a company's executive remuneration, timely disclosure of information regarding the development and operation of each policy is also essential. Therefore, we promote the provision of clear and concise information about the design of the scheme, the underlying targets that are used to assess performance awards, and the total quantum of reward that is possible.

When reviewing remuneration proposals, we generally favour the following:

- we typically favour the use of a maximum cap on long term incentive schemes to limit the total compensation available at an appropriate level. We will, however, review each policy on a case-by-case basis and will support innovative structures which do not necessarily fit with conventional practices, but which are appropriate for a company's individual circumstances.
  - whilst we recognise that circumstances can change, we prefer that investee companies' pay policies are consistent, long-term structures and we are therefore not usually supportive of regular changes and amendments.
- There are also a number of particular pay practices which we will typically not support:
- repricing of equity awards
  - retesting of performance conditions
  - vesting of incentive awards for below median performance
  - incentive-based awards for non-executive directors
  - severance agreements which (i) are excessive relative to market practice and/or (ii) allow accelerated vesting of variable pay awards without pro-rating for time and performance.
- Whenever a company's remuneration policy or report is significantly below expectation we will consider taking voting action against any relevant pay proposals on the ballot, against the Chairman of the Remuneration Committee, and if appropriate against the Chairman of the board and other independent directors where appropriate.
- we prefer that a substantial proportion of total reward potential for senior executives is made up of variable performance-based pay that it is subject to deferral and clawback provisions. Performance for long-term incentives should be measured over a minimum three year period.

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## V. SUSTAINABILITY

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We believe that a company cannot be financially sustainable in the long run if its approach to business is fundamentally out of line with changing societal expectations. We consider each of the following sustainability risks and opportunities in the context of our overall focus on long-term investment performance.

As a minimum, we expect all holdings to operate in accordance with the principles and standards set out in the United Nations Global Compact. Whenever a company’s performance on any of the following issues is significantly below expectation, and is thereby a material risk to the long-term performance of their business, we will engage with management in the first instance before considering taking appropriate voting action.

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### RESPONSIBLE BUSINESS PRACTICES

We expect that all of our holdings operate their businesses in a way that takes account of all relevant legal and regulatory guidelines and which is supportive of good stakeholder relations. Relevant areas of practice include responsible marketing, tax optimisation, governance of data privacy and security, and the company’s management of product and service issues such as product quality and integrity, complaint handling, safety recalls and compensation.

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### DIVERSITY

We believe that employee diversity is an increasingly important issue for all businesses, and we expect our holdings to take steps to understand and, where necessary, improve employee diversity in all of its forms. We further expect businesses to carefully monitor and manage the culture within their organisation to ensure that all employees are treated with respect in the workplace. Suitable policies and processes should be in place to ensure that inappropriate behaviour is identified and addressed.

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### COMBATING BRIBERY AND CORRUPTION

We expect that all of our holdings work against corruption in all its forms, including extortion and bribery. For companies in the extractive industries, we support active participation in the Extractive Industries Transparency Initiative. We expect to see appropriate conduct and compliance programmes reinforced by leadership, policies and training, and appropriate reporting procedures such as confidential ‘whistle-blower’ lines. We would also not ordinarily expect our holdings to make political donations or contributions to ‘politically exposed’ charitable organisations.

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### HUMAN RIGHTS AND LABOUR RIGHTS

We expect that all of our holdings respect internationally accepted human rights and labour rights throughout their business operations and value chain. As a minimum this should include the maintenance of health, safety and wellbeing management systems, particularly in high-risk sectors; the management of exposure to labour and human rights risks throughout their value chain, in particular human slavery; and the encouragement of positive relationships with local communities.

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### CLIMATE CHANGE AND OTHER ENVIRONMENTAL IMPACTS AND RISKS

We expect that all of our holdings undertake steps to understand environmental risks confronting their business and to manage the environmental impacts relating to their business, with a particular focus on climate change where the risks, and/or opportunities are material. Climate-related risks may include environmental regulation and taxation, resource availability, business and/or supply chain disruption and changing customer expectations. Financial risks may include increased capital expenditure, reduced revenues and expenses relating to property/asset adaptation, or repair.

Companies should take all appropriate steps to reduce direct and indirect greenhouse gas emissions, integrate climate change policies into business strategies, and enhance disclosure on climate change and other significant environmental risks so that investors can reliably and comparably assess associated investment risks and opportunities.

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## IMPORTANT INFORMATION

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Baillie Gifford & Co and Baillie Gifford & Co Limited are authorised and regulated by the Financial Conduct Authority (FCA). Baillie Gifford & Co Limited is an Authorised Corporate Director of OEICs.

Baillie Gifford Overseas Limited provides investment management and advisory services to non-UK Professional/Institutional clients only. Baillie Gifford Overseas Limited is wholly owned by Baillie Gifford & Co. Baillie Gifford & Co and Baillie Gifford Overseas Limited are authorised and regulated by the FCA in the UK.

Baillie Gifford Investment Management (Europe) Limited provides investment management and advisory services to European (excluding UK) clients. It was incorporated in Ireland in May 2018 and is authorised by the Central Bank of Ireland. Through its MiFID passport, it has established Baillie Gifford Investment Management (Europe) Limited (Frankfurt Branch) to market its investment management and advisory services and distribute Baillie Gifford Worldwide Funds plc in Germany. Baillie Gifford Investment Management (Europe) Limited is a wholly owned subsidiary of Baillie Gifford Overseas Limited, which is wholly owned by Baillie Gifford & Co.

Persons resident or domiciled out with the UK should consult with their professional advisers as to whether they require any governmental or other consents in order to enable them to invest, and with their tax advisers for advice relevant to their own particular circumstances.

### **Important Information Hong Kong**

Baillie Gifford Asia (Hong Kong) Limited 百利亞洲(香港)有限公司 is wholly owned by Baillie Gifford Overseas Limited and holds a Type 1 licence from the Securities & Futures Commission of Hong Kong to market and distribute Baillie Gifford's range of UCITS funds to professional investors in Hong Kong. Baillie Gifford Asia (Hong Kong) Limited 百利亞洲(香港)有限公司 can be contacted at 30/F, One International Finance Centre, 1 Harbour View Street, Central, Hong Kong. Telephone +852 3756 5700.

### **Important Information South Africa**

Baillie Gifford Overseas Limited is registered as a Foreign Financial Services Provider with the Financial Sector Conduct Authority in South Africa.

### **Important Information South Korea**

Baillie Gifford Overseas Limited is licensed with the Financial Services Commission in South Korea as a cross border Discretionary Investment Manager and Non-discretionary Investment Adviser.

### **Important Information Japan**

Mitsubishi UFJ Baillie Gifford Asset Management Limited ('MUBGAM') is a joint venture company between Mitsubishi UFJ Trust & Banking Corporation and Baillie Gifford Overseas Limited. MUBGAM is authorised and regulated by the Financial Conduct Authority.

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This material is provided on the basis that you are a wholesale client as defined within s761G of the Corporations Act 2001 (Cth). Baillie Gifford Overseas Limited (ARBN 118 567 178) is registered as a foreign company under the Corporations Act 2001 (Cth). It is exempt from the requirement to hold an Australian Financial Services License under the Corporations Act 2001 (Cth) in respect of these financial services provided to Australian wholesale clients. Baillie Gifford Overseas Limited is authorised and regulated by the Financial Conduct Authority under UK laws which differ from those applicable in Australia.

### **Important Information North America**

Baillie Gifford International LLC is wholly owned by Baillie Gifford Overseas Limited; it was formed in Delaware in 2005. It is the legal entity through which Baillie Gifford Overseas Limited provides client service and marketing functions in America as well as some marketing functions in Canada. Baillie Gifford Overseas Limited is registered as an Investment Adviser with the Securities & Exchange Commission in the United States of America.

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